United States Government Bonds

By C. Frederick Childs

President, C. F. Childs and Co., New York and Chicago

The Nature of Government Bonds

A GOVERNMENT bond is primarily a loan which the legally constituted national authorities covenant and promise to pay on a specified date. Being, therefore, the obligation of a nation, such a bond represents a form of credit of the utmost superiority. The bond of a government presupposes that the nation borrowing the money is entitled to the accommodation which it seeks, and does so in unimpeachable good faith and integrity for the welfare of its people. When founded upon the strictest observance of all past commitments and supplemented by the lender's recognition of the standing of the borrowing nation and its estimated resources, the obligation is entitled to the fullest confidence on the part of foreign, as well as domestic investors.

A national loan should not be regarded as in the same class with a state, municipal or corporation bond, since the debt of a government supersedes all obligations of any minor political body or subdivision. Even the sacrifice of the credit or solvency of any municipality is of small importance when the financial standing of the sovereign state is at stake. In the latter case the faith and credit of the entire nation and all its units and peoples is pledged to honor its obligations, and taxes may be levied accordingly without regard to the needs or sacrifices of any subordinate community or corporate body. A national loan is therefore a veritable mortgage on the integrity, wealth and taxable assets of the entire population, and when such a loan ceases to be safe, then no other known security or investment based upon property within that nation will have any dependable market value. The default of a national obligation would be an absolute calamity to the entire commercial structure and credit of its people, and the money of such a nation would become virtually worthless. No such situation, therefore, is conceivable in the case of the United States Government and its bonds. The government's power to control all the resources, wealth and productivity of the nation, coupled with unlimited powers of taxation, constitutes the economic vitality of the nation in support of any desired credit.

National Finance

History records that a liberal application of taxation is the surest method of marshalling national resources for the successful financing of every great national calamity or crisis. The records of the Napoleonic Wars indicate that at that time over 40 per cent of the cost of the wars was paid by direct taxation. At the close of our Great War just ended, it was estimated that taxation was producing about 35 per cent of the actual daily cost of the war. In consequence, it becomes apparent that submission to such sacrifices on the part of a nation's citizens

makes its government capable of fulfilling any duty necessary to honor its debts. Responsive patriotism to a like degree assures the government that public support will safeguard all its accompanying moral and financial obligations.

WEALTH, DEBT AND INCOME OF THE UNITED STATES

Before the United States entered the late war our net national debt was approximately $1,000,000,000. The gross cost of the war to the United States up to June 30, 1919, was computed by the Secretary of the Treasury to have been $30,177,000,000. To meet the treasury's needs to conduct the war and its unprecedented expenditures, there were issued and sold to the public $16,978,356,250 bonds and $4,500,000,000 notes. Also various other obligations were incurred, notably War-Savings Stamps and Certificates and serial issues of short term Treasury Notes sufficient to make the gross debt of the United States up to June 30, 1919, total $25,484,506,160. To better appreciate the significance of such figures, the contrast between the estimated wealth, net debt and annual income of the United States might be shown in round numbers as follows:

Wealth	$300,000,000,000
Debt	$20,000,000,000
Income	$50,000,000,000

By an obvious analysis of these figures, the net debt of the government is only about 40 per cent of our country's income for one year. Similarly, if we assume that the government's yearly rental or interest charge for the use of the money represented by the loans averages $4\frac{1}{4}$ per cent on the bonds and $4\frac{1}{2}$ per cent on the notes, it is evident that our income is equivalent to about fifty-six times the interest requirements on the national debt. By comparison, the average corporation bond purchased by investors shows earnings of only about two to five times the interest charges.

Although not generally realized, our financial burdens today are not altogether disproportionate to those immediately following the Civil War. A comparison of the data indicates that the debt of the United States after the Civil War was $80 per capita, or $10\frac{1}{2}$ per cent of our national wealth. Today our debt is about $275 per capita and the percentage of our debt to our national wealth is now about 10 per cent. The tremendous increase in our wealth during the last fifty years, coupled with the general prosperity which has accompanied the marked development of our resources recently, does not indicate that our present burdens are so difficult to bear as was the weight of the Civil War debt.

AMOUNT OF GOVERNMENT BONDS OUTSTANDING

Without reference to the bonds which were outstanding prior to the year 1917, there was issued and sold, within approximately two years from April 2, 1917, the date of our entrance into the war, $21,478,357,250 Liberty Loans, of which amount $4,500,000,000 were designated as Victory (short-time) Notes. All were sold at par, as the several different issues were announced, direct to institutions or individual investors through an organization of volunteers under the direct supervision of the twelve Federal Reserve Banks. The districts allotted to each Federal Reserve Bank, covering the

entire United States, were subdivided into state, county, city and town organizations so that every individual throughout the entire country was directly or personally appealed to for subscriptions up to the limit of his financial ability. These intensive campaigns by personal solicitations, which were conducted, without salary compensations for the most part, by bankers and experienced bond salesmen, were supplemented with literature, posters and advertisements issued by the treasury department.

Date of Various Loans

The emission of the various loans was made as follows, and the campaigns necessary to complete subscriptions for the amount of each loan were usually extended over a period of about thirty days:

Loans		*Offered*	
First Liberty	$3\frac{1}{2}$s	May	14, 1917
Second "	4s	October	1, 1917
Third "	$4\frac{1}{4}$s	April	6, 1918
Fourth "	$4\frac{1}{4}$s	September	28, 1918
Victory Liberty	$3\frac{3}{4}$s and $4\frac{3}{4}$s	April	21, 1919

The $3\frac{1}{2}$ per cent and $3\frac{3}{4}$ per cent loans were made absolutely exempt from all taxation both as to principal and interest during their life, whereas the 4s, $4\frac{1}{4}$s and $4\frac{3}{4}$s were given specific and different tax exempt characteristics. To the $3\frac{1}{2}$s and 4s was attached the privilege of conversion into the $4\frac{1}{4}$ per cent rate and to the $3\frac{3}{4}$s and $4\frac{3}{4}$s were given convertible and reconvertible privileges. Under the various acts of Congress authorizing the 4 per cent, $4\frac{1}{4}$ per cent and $4\frac{3}{4}$ per cent loans, different privileges of tax-exemption were granted and applied to certain limited amounts of bonds provided they were originally subscribed for or later purchased by investors in the open market. These made it possible for a holder of a maximum amount of $160,000 bonds, consisting of a combination of the different issues, to have the income thereof tax-exempt for a period of time ranging from two to five years after the formal declaration of peace by the President of the United States.

The maximum face amounts of the different United States issues of Liberty Bonds, exclusive of holdings of $3\frac{1}{2}$s and $3\frac{3}{4}$s which an investor may hold, still obtaining exemption from taxation on all the resulting income, may be tabulated as follows:

$5,000 in the aggregate of First 4s, First $4\frac{1}{4}$s (issues of May 9, 1918, and October 24, 1918), Second 4s and $4\frac{1}{4}$s, Third $4\frac{1}{4}$s, Fourth $4\frac{1}{4}$s, Treasury Certificates, and War-Savings Certificates.

30,000 of First $4\frac{1}{4}$s (issue of October 24, 1918, only), until the expiration of two years after the termination of the war.

30,000 of Fourth $4\frac{1}{4}$s, until the expiration of two years after the termination of the war.

45,000 in the aggregate of First 4s, First $4\frac{1}{4}$s (issue of May 9, 1918, only), Second 4s and $4\frac{1}{4}$s, and Third $4\frac{1}{4}$s, as to the interest received after January 1, 1918, until the expiration of two years after the termination of the war—this exemption conditional on original subscription to, and continued holding at date of tax return of, two-thirds as many bonds of the Fourth Liberty Loan.

$110,000 Total possible exemptions, subject to conditions above summarized. Under the terms of Section 2 (a) of the Victory Liberty Loan Act, the following additional exemption becomes immediately effective, and is independent of any subscription to the Victory Liberty Loan.

$30,000 in the aggregate of First 4s, First 4¼s (issues of May 9, 1918, and October 24, 1918), Second 4s and 4¼s, Third 4¼s, and Fourth 4¼s, as to the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war. Under the terms of Section 2 (b) of the Victory Liberty Loan Act, the following additional exemption is provided, conditional upon original subscription to, and continued holding at the date of the tax return of, one-third as many notes of the Victory Liberty Loan, and extending through the life of the notes of the Victory Liberty Loan instead of expiring five years after the termination of the war:

$20,000 in the aggregate of First 4s, First 4¼s (issues of May 9, 1918, and October 24, 1918), Second 4s and 4¼s, Third 4¼s, and Fourth 4¼s, as to the interest received on and after January 1, 1919.

$160,000 Total.

Market Values of the Different Issues

The market value of the several different loans is subject to the daily vacillating sentiments of the present holders and prospective buyers. Every condition of local or foreign significance has a direct bearing upon the market which, however, is primarily governed by the supply and demand. When it is realized that prior to the war there were approximately four hundred thousand recognized bond buyers in the United States, and that, impelled by patriotic motives and drastic solicitation, fully twenty million people of this country were successfully induced to subscribe for the War Loan Bonds, it is not surprising that a large percentage of the subscribers should endeavor to liquidate their bonds by selling them in the open market as soon as the war ended. In consequence, the supply of bonds tendered for sale greatly exceeded the demand of investors who were ready to add to their holdings by purchasing additional amounts. The result naturally produced a constantly declining market. As a means of forestalling a precipitate decline, and for the purpose of constantly supporting and steadying the market, the most potent factor was the War Finance Corporation which possessed adequate powers and means for functioning in that capacity for the government. Its daily purchases and sales frequently totaled several million dollars par value of bonds. Similarly (and most effectively) the operation of the government sinking fund was arranged to retire and cancel a proportionate amount of $18,000,000,000 bonds annually during a period of twenty-five years. For the annual sinking fund to extinguish the principal in addition to the funds necessary to meet the interest on the bonds, $417,861,532 will be required, or 2.32 per cent of the respective amount of Liberty Loan Bonds outstanding.

Up to the present writing the following prices show the lowest level to which the different loans have declined since their issuance:

			Low Recorded Quotation
First	Issue	3½s	97.20
First	"	4s	92.20
Second	"	4s	92.10
First	"	4¼s	93.90
Second	"	4¼s	92.70
First-Second		4¼s	94.30
Third	"	4¼s	94.00
Fourth	"	4¼s	92.70
Fifth	"	3¾s	99.28
Fifth	"	4¾s	99.28

Owing to the fact that the chief influence attracting buyers of bonds bearing as low a rate as government loans is the tax-exempt feature (exclusive of any patriotic consideration), it is manifest that the $3\frac{1}{2}$s and $3\frac{3}{4}$s, which are totally tax-exempt would be selected for purchase by individuals or institutions of large wealth who would otherwise be subject to heaviest taxation under the Income Tax Law. Therefore, these two issues virtually stand alone marketwise on their merits. With respect to the 4s which are now convertible at any time into a $4\frac{1}{4}$ per cent rate and also all the $4\frac{1}{4}$ per cent issues, there does not exist a sufficient distinction in their accompanying taxation features to justify any comparative difference in their market value. Therefore, the principal variance in their quoted prices is primarily based upon their different maturity dates, coupled with the fact that there is a marked difference between the amount of bonds outstanding. In general, all $4\frac{1}{4}$ per cent bonds should be quoted on a parity basis of income yield so that a ten-year bond and a twenty-five-year bond should sell at prices to yield the same net return. However, as long as the vast number of public holders of these bonds are unable to comprehend or to act with appreciable discrimination, but instead select for purchase or sale one issue instead of another without reference to this technicality, it is not probable that any factor except that of supply and demand will exercise any considerable market influence over prices until the greater portion of bonds are lodged in the hands of discriminating investors. As a general rule, the most inexperienced investors select by preference short, rather than long time maturities. The two different issues of First $4\frac{1}{4}$s afford another conspicuous example of a notable price difference. Both of these bonds exist as the result of converting a $3\frac{1}{2}$ per cent bond into the $4\frac{1}{4}$ per cent rate under two different Acts of Congress. In the case of the First Liberty Loan Converted $4\frac{1}{4}$s, issue of May 9, there are nearly $380,000,000 bonds outstanding, whereas in the case of the First Liberty Loan Second Converted $4\frac{1}{4}$s, issue of October 24, there are outstanding less than $3,500,000. Bonds of the former loan are available in sufficient amounts to meet the demand and still be quoted at a substantial discount, but bonds of the latter loan, on the other hand, are scarce and virtually unobtainable in the open market, which fact causes them to be quoted at a premium when an occasional block of bonds becomes obtainable.

On the assumption that the government will not call the Liberty Loan Bonds for redemption at their optional date, but rather will allow them to run to maturity, the prices at which the different bonds should be quoted in order that a $4\frac{1}{2}$ per cent and 5 per cent income yield shall be obtained by the buyer are specified below. It is assumed that bonds bought January 1, 1920, will be retained until maturity:

			Maturity	*Price to Yield $4\frac{1}{2}$%*	*Price to Yield 5%*
Liberty		$3\frac{1}{2}$s	1947	84.31	77.71
	1st	4s	1947	92.16	85.14
	2nd	4s	1942	92.88	86.42
	1st	$4\frac{1}{4}$s	1947	96.08	88.86
	2nd	$4\frac{1}{4}$s	1942	96.44	89.82
	3rd	$4\frac{1}{4}$s	1928	98.17	94.62
	4th	$4\frac{1}{4}$s	1938	96.83	90.87
Victory		$3\frac{3}{4}$s	1923	97.59	96.03
		$4\frac{3}{4}$s	1923	100.80	99.21

CHARACTERISTICS OF

The principal characteristics of the ten different issues

UNITED STATES LIBERTY AND

	3½s	4s		
	1ST LIBERTY LOAN 3½s *15–30 Year Bonds*	1ST LIBERTY LOAN—CONVERTED 4s *15–30 Year Bonds*	2ND LIBERTY LOAN 4s *10–25 Year Bonds*	1ST LIBERTY LOAN—CONVERTED 4¼s **Issue of May 9, 1918* *15–30 Year Bonds*
Present Status	Issued $2,000,000,000. †Outstanding $1,413,805,200.	†Outstanding $198,865,200.	Issued $3,808,766,150. †Outstanding $860,365,100.	†Outstanding $376,129,100.
Taxation Feature (Summary Below)	Exempt from all taxes (except estate and inheritance taxes).	Notes A, B, F and G.	Notes A, B, F and G.	Notes A, B, C, F and G.
Date of Issue and Maturity	June 15, 1917. June 15, 1947.	November 15, 1917. June 15, 1947.	November 15, 1917. November 15, 1942.	May 9, 1918. June 15, 1947.
Callable For Payment	Redeemable at government's option on or after June 15, 1932.	Redeemable at government's option on or after June 15, 1932.	Redeemable at government's option on or after Nov. 15, 1927.	Redeemable at government's option on or after June 15, 1932.
Interest Payments	June 15th and Dec. 15th.	June 15th and Dec. 15th.	May 15th and Nov. 15th.	June 15th and Dec. 15th.
Conversion Privilege	Convertible into any higher rate bond issued during the war (except short term loans) within six months from date of the issue of such higher rate bond. The date of the termination of the war shall be date fixed by proclamation of the President.	Convertible into the First Converted 4¼s if application is made before Nov. 9, 1918. This privilege to convert has been extended and renewed.	Convertible into Second Converted 4¼s if application is made before Nov. 9, 1918. This privilege to convert has been extended and renewed.	Not convertible into any future issue.
Sinking Fund	Note H.	Notes E and H.	Notes E and H.	Notes E and H.

Note A.—Exempt from state and local taxes and from normal income tax, but subject to estate, inheritance, super-tax, excess and war-profits tax on all incomes and earnings above the normal exemption (incomes from holdings of $5,000 bonds are tax exempt except for estate and inheritance taxes).

Note B.—In addition to tax exemption in Note A, income from not more than $45,000 bonds of this issue or a smaller amount of bonds of this issue not exceeding 1½ times the amount of the Fourth Liberty Bonds held by the owner is exempt until two years after the war from surtaxes, excess and war-profits taxes, provided said Fourth Loan Bonds were originally subscribed for and have been continuously owned by the tax payer up to the date of his tax return.

Note C.—Bonds owned continuously for at least six months prior to one's death are acceptable at par and accrued interest in payment of any estate and inheritance taxes imposed by the United States under any present or future law.

Note D.—In addition to the tax exemption in Note A, interest on not to exceed $30,000 bonds of this issue is exempt until two years after the war from surtaxes, excess and war-profits taxes when owned by one individual, partnership, corporation or association.

Note E.—The Secretary of the Treasury is authorized from time to time until the expiration of one year after the termination of the war to buy bonds of this issue to the extent of 5% of the original issue during the 12 months' period beginning on the date of issue and in each 12 months' period thereafter to the extent of 5% of the amount outstanding at the beginning of the period, the average cost of bonds purchased in any such 12 months' period not to exceed par and accrued interest.

Note F.—In addition to the tax exemption in Note A, income received on and after January 1, 1919, on not to exceed $30,000 bonds in the aggregate is exempt until the expiration of five years after the war from surtaxes, excess and war-profits taxes.

Note G.—In addition to the tax exemption in Note F, income received on and after January 1, 1919, on not to exceed $20,000 bonds in the aggregate is exempt from surtaxes, excess and war-profits taxes, extending through the

DIFFERENT ISSUES

of Liberty and Victory Loans are set forth below.

VICTORY LOAN WAR BONDS

4¼s				3¾s and 4¾s
1ST LIBERTY LOAN—2ND CONVERTED 4¼s **Issue of Oct. 24, 1918 15–30 Year Bonds*	2ND LIBERTY LOAN—CONVERTED 4¼s *10–25 Year Bonds*	3RD LIBERTY LOAN 4¼s *10 Year Bonds*	4TH LIBERTY LOAN 4¼s *15–20 Year Bonds*	VICTORY LIBERTY LOAN *3–4 Year Notes*
Available by converting 3½s before April 24, 1919. Outstanding approximately $3,375,000.	†Outstanding $2,752,153,400.	Issued $4,176,516,850. †Outstanding $4,055,687,050.	Issued $6,993,073,250. †Outstanding $6,917,000,000.	Issued $4,500,000,000.
Notes A, C, D, F and G.	Notes A, B, C, F and G.	Notes A, B, C, F and G.	Notes A, C, D, F and G.	Notes I and J. Note C, as to 4¾s only.
October 24, 1918.	May 9, 1918.	May 9, 1918.	October 24, 1918.	May 20, 1919.
June 15, 1947.	November 15, 1942.	September 15, 1928.	October 15, 1938.	May 20, 1923.
Redeemable at government's option on or after June 15, 1932.	Redeemable at government's option on or after Nov. 15, 1927.	Not redeemable until maturity.	Redeemable at government's option on or after Oct. 15, 1933.	Redeemable at government's option on or after June 15, 1922, upon not less than four months' notice.
June 15th and Dec. 15th.	May 15th and Nov. 15th.	September 15th and March 15th.	April 15th and October 15th.	December 15th and June 15th.
Not convertible into any future issue.	Not convertible into any future issue.	Not convertible into any future issue.	Not convertible into any future issue.	The 3¾s and 4¾s are convertible and reconvertible each into the other after July 15, 1919, but before maturity or call for redemption.
Notes E and H.	Notes E and H.	Notes E and H.	Notes E and H.	Notes E and H.

life of the Victory Notes, provided such bonds do not exceed three times the principal amount of Notes of the Victory Liberty Loan originally subscribed for by such owner and still held by him at the date of his tax return.

Note H.—The Victory Loan Act created a sinking fund to retire all Liberty bond and note issues at maturity, or to redeem and purchase them before maturity at an average cost not to exceed 100 and accrued interest. Beginning July 1st, 1920, and for each fiscal year thereafter until all such bonds and notes are redeemed, there is appropriated for the purposes of the sinking fund an amount equal to the sum of (1) 2½% of the aggregate amount of bonds and notes outstanding on July 1st, 1920, less an amount equal to the par amount of any obligations of foreign governments held by the United States on July 1st, 1920, and (2) the interest which would have been payable on the bonds and notes purchased or redeemed or paid out of the sinking fund during such year or in previous years for which the appropriation was made.

Note I.—The 3¾s are exempt both as to principal and interest from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, any State or any of the possessions of the United States, or by any local taxing authority.

Note J.—The 4¾s are exempt both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except estate or inheritance taxes, and graduated additional income taxes, commonly known as surtaxes, and excess profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations or corporations.

* The two issues of First Converted 4¼s differ only to the extent that the issue of October 24th is tax exempt as to the interest on not to exceed $30,000 bonds regardless of one's subscription to the Fourth Loan, whereas the issue of May 9th is tax exempt as to the interest on not to exceed $45,000 bonds in connection with one's subscription to the Fourth Loan.

† Outstanding January 31, 1919.

Above data revised to June 1, 1919.

Apart from these technical considerations, there are no grades or classes in the credit of our government, and the bonds of one loan of the United States are equal in safety with any and all other loans which our government has obligated itself to pay.

PRE-WAR BONDS

There are now outstanding seven different pre-war issues, three of which are suitable primarily as collateral security for National Bank notes, the remaining four being regarded as more or less suitable for public investment. They are classified as follows:

$599,724,050	Consol 2s (payable at the pleasure of the government after April 1, 1930).
74,901,580	Panama 2s (redeemable at the government's option after August 1, 1916, and November 1, 1918, and payable August 1, 1936, and November 1, 1938).
11,250,000	Postal Savings $2\frac{1}{2}$s (redeemable one year after date of issue and payable twenty years from date of issue).
50,000,000	Panama 3s (payable June 1, 1961).
28,894,500	Conversion 3s (payable January 1, 1946).
118,489,900	Old 4s (redeemable at the pleasure of the government after February 1, 1925).

The Consol 2s and Old 4s are the consolidated and refunded debts created during previous wars and national crises, and the Panama 2s were issued to defray in part the cost of constructing the Panama Canal. These three issues are now, for the most part, utilized by national banks and pledged in Washington to secure the issuance of national bank notes.

The Conversion 3s were created by refunding a certain amount of Consol 2s and Panama 2s acquired in 1914 by the Federal Reserve Banks at par. The new converted 3 per cent bonds were thereafter sold to the public.

The Panama 3s were issued primarily to complete payment for the cost of the Panama Canal, and the Postal Savings Bank $2\frac{1}{2}$s were issued to encourage the purchase of a government investment on the part of small savings bank depositors, and more particularly foreign born laborers who otherwise would withhold their earnings from the banks.

As the Federal Reserve Bank Act, providing rediscount privileges for the benefit of all national banks also extends the bank note issuing privilege to Federal Reserve Banks (which was formerly granted only to national banks), it is not likely that any future refunding of the present Liberty Loans will result in authorizing any new issue having the bank note circulation privilege attached to them. Therefore, it is probably safe to assume that without this privilege, no future issue of United States Bonds can be sold, during the present generation at least, bearing as low a rate of interest as 2 per cent; and, furthermore, it is improbable that the outstanding 2 per cent bonds will be called for payment so long as they can be profitably utilized by national banks for securing circulation. A notable commentary on the value of the circulation privilege is the fact that the 2s and Old 4s are now quoted at $100\frac{1}{4}$ and $106\frac{1}{2}$ respectively.